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In the Supreme Court of the United States

October Term, 1958

L. BRYAN BERGESON, Petitioner

vs.

LIFE INSURANCE CORPORATION OF AMERICA, a corporation; CLEO H. BULLARD; LEWIS R. RICH; ADRIAN S. WRIGHT; W. MEEKS WIRTHLIN; HARRY D. PUGSLEY; LAWRENCE H. BIRRELL; HERBERT J. ZIMMERMAN; and J. ROBERT THOMAS, Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT

L. Bryan Bergeson respectfully prays that a Writ of Certiorari be issued out of and under the seal of this court to review the judgment of the United States Court of Appeals for the Tenth Circuit entered in the above entitled case on March 16, 1959.

OPINIONS BELOW

The opinion of the District Court (R. 138-151) is reported at 170 Federal Supplement 150. Inasmuch as nine copies of the record as printed for the Circuit Court are filed herewith,

under the provisions of paragraph 4 of Rule 21 of the rules of this court, it is not reproduced in this petition. The opinion of the Court of Appeals has not yet been reported. It appears at pages 4-24 of the Circuit record and is attached to this petition as Appendix A. (The main record as presented to the Circuit Court is referred to in this petition as "R...."; Supplemental Records are particularly denominated as such; the Circuit Proceedings, consisting of the Orders of Submission, Opinion, Judgment, Petition for Rehearing, Order Denying Petition for Rehearing, Notes on Mandate and Clerk's Certificate are referred to as the "Circuit Record" or "Cir. R. ...." to avoid confusion.)

JURISDICTION

The judgment of the Court of Appeals was entered on March 16, 1959. A Petition for Rehearing was denied on April 17, 1959. The jurisdiction of this court is invoked under the provisions of 28 U.S.CA. Section 1254(1).

QUESTIONS INVOLVED

1. In a state court, a corporation plaintiff and an individual defendant entered into a stipulation and obtained an order confirming it, whereby the corporation purported to discharge the defendant for all obligations including the obligation for the payment of stock. As between the corporation and the plaintiff in this action, the corporation was without power to enter into the stipulation. The defendant in the state action was charged with knowledge of the corporate lack of power. Plaintiff in the case at bar, a minority stockholder, asserted the corporate right against the state court defendant including the right to require him to pay for stock and moved

for an order enjoining the interposition of the state court order or stipulation as a defense. The question presented is, does a federal district court have the power notwithstanding Sec. 28 U.S.C.A. 2283 to enjoin the interposition of a state court order as a defense of res adjudicata in such circumstances, under the authority of Wells Fargo and Co. v. Taylor (1920) 254 U.S. 175, 65 L.Ed 205, 41 Sup. Ct. 93?

2. Whether when a United States Court of Appeals disregards the facts presented to it for decision and renders a decision on a hypothetical statement of facts not before the court and contrary to the facts found by the trial court, it complies with Rule 52(a) of the Rules of Civil Procedure promulgated by this court.

3. Whether a Court of Appeals may entirely disregard applicable substantive law of a state in (1) failing to observe the distinction between a mutual insurance company and a corporate insurer owned by stockholders, (2) ignoring the state rule with respect to duties of promoters as applied in *Old Dominion Copper and Smelting Co. v. Bigelow*, 203 Mass. 159, 89 N.E. 193, and (3) ignoring the state standards established with respect to the duties of fiduciaries.

STATUTES AND REGULATIONS INVOLVED

The federal statutes and rules of Civil Procedure involved are as follows:

28 U.S.C.A. Section 2283:

> "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or

effectuate its judgments. June 25, 1948, c. 646, 62 Stat. 968."

Construed in *Wells Fargo & Co. Taylor*, 254 U.S. 175, 65 L.Ed 205, 41 Sup. Ct. 93.

Rule 52(a) Federal Rules of Civil Procedure:

> "Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Finding of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of the fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b)."

The more important State Statutes involved are contained in Appendix 1.

STATEMENT OF FACTS

This is a derivative stockholders' suit. Jurisdiction of the district court in the first instance was predicated upon diversity of citizenship. Plaintiff is a citizen of the state of Idaho; all defendants are citizens of the State of Utah. The amount in controversy exceeds $3,000.00. The suit was filed

in two causes of action. In the second cause of action plaintiff asserted that the defendants Bullard, Wright, Wirthlin, Pugsley and Rich issued stock of the defendant corporation to themselves without any consideration. The trial court held that the corporation was entitled to recover $40,000 plus interest against the individual defendants (except Pugsley) in accordance with plaintiff's prayer on this cause of action. In his first cause of action plaintiff alleges in substance that at the time of the organization of the defendant corporation, the individual defendants caused it to come into existence under circumstances where it had an impaired financial condition, notwithstanding all of the individual defendants were charged with the duties of fiduciaries and they represented to the corporation and certain state officials that the corporation had assets of $214,780.00 and no liabilities. The corporation's impaired financial condition resulted from a combination of two circumstances: (1) The items represented as assets were worthless for the most part, and (2)Such assets as had value were used to pay outstanding bills of a mutual company which had been operating at a loss for approximately two years. Some of the defendants (sometimes referred to herein as the LICOA partnership) had claims against the mutual company which were not disclosed to the stock company at the time it was brought into existence. Both the district court and the trial court held that the plaintiff had the right to maintain this action in behalf of the corporation and that the requirements of Rule 23(b) of the Federal Rules of Civil Procedure had been discharged. The trial court held on the first cause of action that the defendants were guilty of negligence or fraud or other violation of fiduciary duties but that the corporation had not suffered any damage as the proximate result of their misconduct. On that ground, it granted motion for summary judgments. The trial court held

that failure to disclose the claims of the promoters to the stockholders violated the duty owed by them as fiduciaries, as far as the second cause of action was concerned, and since they had caused the corporation to issue stock for the advances to the mutual company, the stock corporation receiving no benefit therefrom, entered judgment for the value of the stock. The second cause of action included a claim for payment of stock issued by the corporation as overriding commissions on business transacted.

The Circuit sustained the judgment for defendants on the first cause of action and the judgment for the amount of stock issued as commissions on the second cause, but reversed the trial judge to the extent that he awarded damages on the second cause for stock issued in consideration of advances to the mutual company.

The record at this point in the proceedings consists of depositions, affidavits, written interrogatories, a partial transcript of the pretrial conference and various other proceedings in the district court, including a stipulation of facts. The depositions and interrogatories were primarily intended as discovery devices. A considerable portion of the testimony at the depositions consists of self-serving statements of the individual defendants, and there is no small amount of hearsay testimony which could not have been properly received at a trial. All of the proceedings in the trial court, including the ruling of the trial judge on the motion for summary judgment and the judgment in favor of the corporation, in accordance with plaintiff's prayer for relief on the second cause of action, were on the theory that in fact and in law a mutual benefit insurer was a different kind of a legal creature than a stock corporation. The Circuit Court held, however, that the mutual

company and a stock company were one and the same company.

Further amplification of the facts is required to explain the legal questions involved. Sometime during 1951, the defendants, Bullard, Wright and Wirthlin and three other persons not involved in this litigation, organized a partnership known as LICOA Agency (R. 99, 128). In 1952 defendants Rich and Pugsley became partners of the LICOA Agency through a purchase of interest of other members of the partners (R. 99, 359, 40).

The LICOA partnership desired to manage, as directors and officers, a life insurance company owned by stockholders. The partners expected to receive an overriding commission on all insurance business written by the company (R. 100). The Utah statutes require that before a corporate insurer can obtain a license to do business it must have $125,000.00 in capital and surplus (31-11-1, U.C.A. 1953) the Code prescribing that such assets must be of premium quality (31-12-1, U.C.A. 1953). Lacking either the requisite capital or the desire to risk their own money in the enterprise (R. 362) the LICOA agency members embarked upon a course to secure necessary financing. They determined to first organize a mutual company, since such a company could commence operations with virtually no assets (R. 99) to put some business upon the books (R. 361) and then recommend to the policyholders, which under Utah law, owned and operatied the company (31-9-12, U.C.A. 1953) that it be converted to a stock company, if and when the assets required in such company could be raised.

A mutual benefit insurance company was organized by the LICOA partnership in April, 1951, known as the Life Insurance Corporation of America (R. 36, 99). Members of the partner-

ship advanced to the mutual company amounts required to defray current expenses in the total sum of $28,033.17 (R. 117, trial court finding at 139).

The LICOA group defendants stipulated that the arrangement between the mutual company and the partnership was that these advances would be repaid out of earned surplus (R. 100). The trial court so found (R. 143, 144), and determined that any other arrangement would have violated Section 31-9-29 and 31-9-30 of the Utah Code, Annotated, 1953 (R. 144, 145). The Circuit relied upon the testimony of defendant Bullard and held that the advances were to be repaid in stock (C. R. 16). Yet there was no stock company for two years after the organization of the mutual company, and indeed, it was far from certain that a stock company would ever come into existence.

In May, 1953, the policyholders or "members" of the mutual company were persuaded to adopt an amendment to its articles of incorporation to authorize it to issue 20,000 shares of capital stock of the par value of $10.00. No change was made in the operation at that time, however, the requisite capital for a stock company having not been obtained. No stock was issued at that time.

In August, 1952, an escrow agreement was entered into between the mutual company and Utah Savings and Trust Company under the direction of the Utah State Insurance Commission whereby proceeds from the sales of stock were to be placed in escrow (R. 100, 428). At or about the same time, a permit was obtained from the Utah State Securities Commission to make a public offering of stock (R. 424, 425). The escrow agreement provided in substance that the promoters of the stock company were given ten months within which

to raise $200,000.00 as the minimum capital of the stock company. If the total amount was not obtained within the ten months, the funds obtained and being placed in escrow were to be returned to the subscribers of the stock (R. 107, 108).

Until the minimum amount of capital had been received, the mutual company was to continue to operate as a mutual company (R. 108-110). In other words; the substance of the arrangement was that the stock insurance company had the right to come into existence on the acquisition through the stock sales program of $200,000.00 in assets, and until that time, the mutual company was to continue in operation. The stock company had neither a license to do business nor stockholders, nor officers, nor directors. In a legal sense, the situation was that a condition had been created whereby a stock corporation had a right to achieve legal status upon its acquisition of $200,000.00 in assets.

A stock sales program ensued under the direction of one Mathew J. McCormick, who was persuaded to come to Utah from California to supervise the stock sales activities (R. 100).

The operations of the mutual company were singularly unsuccessful. By the end of June, 1953, the mutual company's assets were in the sum of only $7,488.74. Its liabilities were in the amount of $52,688.99, so that its total deficit was $45,180.25. This deficit included the various advances by the LICOA Agency partnership to the mutual company. An analysis of the affairs of the mutual company appears in Appendix 2 to this petition. The advances of the partnership to the mutual company were not reflected in the books of the mutual company as liabilities (R. 99, 420). They were not disclosed in any manner to any appropriate state officers or

persons to whom stock was being offered. The trial court found "The defendants studiously avoided letting anyone know about this supposed liability" (R. 143). The members of the LICOA Agency and the auditing accountants were, as far as appears, the only persons in possession of these facts.

In June, 1953, a firm of CPA's known as Birrell, Zimmerman, McGee and Thomas, holding itself out as qualified insurance advisors (R. 226-227, 336, 62, 63) was employed to write a letter to the company with respect to its financial condition, and particularly with respect to the proceeds received from the sale of stock. Defendants Birrell, Zimmerman and Thomas were members of the accounting partnership. The suit was dismissed as to McGee when he could not be served. The report was written on June 22, 1953. It is attached to this petition as Appendix 3. In substance it states the company has assets of $214,780.00 and no liabilities. This is the clear and undisputed tenor and substance of the report, notwithstanding the fact that the writer of the letter, Robert L. McGee, knew of the fact that a conversion was contemplated from a mutual to a stock company (R. 282); that he knew or could have readily ascertained that the mutual company was insolvent, and that of the $214,780.00 in purported assets, there were actually only valid, subsisting assets in the amount of $72,225.32 being held in escrow, and there were commissions to the stock salesmen payable on the sale of its stock out of said sum. The Utah Supreme Court eventually held that those commissions, with costs, were in the sum of approximately $30,000.00. In other words, the actual net value of the assets in escrow was only $42,225.32. An analysis of the report and the facts with respect to actual bona fide assets held in escrow is attached to this petition as Appendix 4.

McGee's report of June 2, 1953, was transmitted to the

State Insurance Commission as an audit on the same day it was written (R. 113). The Commission issued a license to do business as a stock insurance company and authorized the release of the escrowed assets on July 7, 1953 (R. 107). Thus such assets as there were in escrow came into the stock company, which was at the same time achieved legal status and was required to assume the obligations of the mutual company. Inasmuch as the actual assets of the stock company were in the net amount of $42,225.32 and the net liabilities of the mutual company were $45,180.25, the stock company began its legal existence with a net deficit of $2,954.93.

The legal proposition asserted by the plaintiff in this case was that the individual defendants owed a duty to the stock company, whose legal existence they procured, to disclose to it all of the relevant facts inherent in the procedure whereby it came into existence. These facts were substantially:

A. That the LICOA partnership had claims against the mutual company in the amount of $28,033.17 plus claimed overriding commissions which the mutual company could not satisfy out of its own assets.

B. The counversion and acquisition of its status as a stock company by Life Insurance Corporation of America would necessarily result in the application of the stockholders' money through the coincidentally organized legal infant to the creditors of the mutual company. The deficit of the mutual company was $45,180.25; $28,033.17 thereof was paid in stock of the new company and the balance, $17,147.08, in cash in the course of business.

C. That whereas the premise of the existence of the stock company was that it had assets of $214,780.00 and no liabili-

ties, in fact it had an actual deficit immediately upon the completion of its organization of $2,954.93.

D. The accountants making the audit had a duty to disclose all the facts, to make the revealed facts not misleading. This was the recognized accounting practice (R. 44) as well as the legal requirement. 3 Restatement on Torts, Sec. 552, esp. comment (b); Cooley on Torts, 4th Ed. Vol. 1, p. 335; National Surety v. Lybrand, (1939) 256, App. Div. 226, 19 N.Y.S. (2d) 454; In re London General Bank (Eng. 1895), 2 Ch. 673.

These assertions were based upon the proposition, undisputed in the trial court, and indeed undisputable, that the mutual company was a separate, distinct legal creature than the stock company. Such was the factual premise in the trial court and such is the clear and unmistakable provision of the Utah statute.

Notwithstanding that these facts were undisputed below, and notwithstanding the holding of other circuits and the provisions of the Utah Code that the mutual company and the stock company were different legal entities, the Circuit held that the defendant stock corporation suffered no damage when its assets were used to pay mutual company creditors. The court held that "If the state officials considered that they had been deceived, they could have taken appropriate steps to reverse the authority, but those steps were never taken . . ." and while "the situation may cause one to lift a querulous eyebrow . . . it does so because the company received a benefit, not because the company suffered any detriment." The presumption of fact—absolutely unsupported — to the effect that the mutual and stock companies were the same entity persuaded the Circuit Court to rationalize that the ad-

vances of the LICOA Agency partnership to the mutual company inured to the benefit of the stock corporation. Thus, it held, the corporation was not damaged when it was caused to issue its stock for the losses incurred by the mutual company.

Notwithstanding the fact that the trial court based its ruling upon the premise that the letter of June 22, 1953 was written negligently or fraudulently, the court held that the payment of the mutual company's bills with the stock company's assets by the device of obtaining a license to do business as a stock company and the release of the escrowed assets into the stock company and thence to the mutual company's creditors was not detrimental to "the company."

Plaintiff relied upon the principle of *Old Dominion Copper Mining and Smelting Co. v. Bigelow*, 203 Mass. 159, 89 N.E. 193. This was the rule applied by the trial court in its ruling that the members of the LICOA partnership were liable at least to the extent of the value of the stock which they caused the corporation to issue to themselves. The Circuit Court grudgingly accepted the trial judge's view that the *Bigelow* rule was applicable in Utah but the court held that the *Bigelow* case applied only when the promoters make a secret profit, and that it did not apply when the promoters' conduct enabled them to recoup a secret loss. Since in its view the mutual company and the stock company were one and the same legal entity, the Circuit Court held that the *Bigelow* rule was not applicable.

A special question exists as to defendant Pugsley. Pugsley was a director of the mutual company, acted as attorney for the mutual company and for the stock company with respect to the preparation and execution of the escrow agreement, filing of the application to sell stock with the State Securities

Commission, preparation of the McCormick contract and in various other capacities (R. 67-68). He was a partner of LICOA Agency from September, 1952, until its dissolution at the end of January, 1954. In April, 1956, he filed an action against the defendant corporation to recover payment for purported services to the corporation as a director. In the early months of 1957 Pugsley had become aware of the fact that some persons were claiming that the corporation ought to sue its former directors for negligence or other violations of duty. He entered into negotiations with the then attorney for the company, Reese C. Anderson, which culminated in the execution of a stipulation in the state court to the effect that Pugsley would release his claim against the corporation upon its payment to him of $200.00 and the corporation's agreeing that Pugsley would be released from all claims it had against him at that time (R. 47-59).

When plaintiff's counsel in the case at bar learned of the execution of that stipulation and the order of the state court approving it, he filed a motion in this case to strike from Pugsley's answer the defense wherein Pugsley claimed the corporation was barred from bringing the action against him and to prohibit Pugsley from "interposing, relying upon or otherwise asserting as a defense in this action" the arrangements concluded with Anderson. These motions were on the ground that the corporation was without power to make the agreement; that it violated the duty which the corporation had to plaintiff and all other minority stockholders; that Pugsley was chargeable with knowledge that his causing the corporation to purport to make such an agreement interfered with the relationship between plaintiff and the corporation, that under the circumstances the purported agreement constituted collusion and fraud as related to the rights of this

plaintiff and other minority stockholders and that the interposition of the defense threatened to impede, delay and interfere with the doings of justice in the case at bar (R. 48, 49). The court struck these motions on its own motion (R. 93). Plaintiff then filed a reply on leave of court setting forth substantially the same principles contained as grounds for his motion (R. 49-50).

Included in the claim against Pugsley in the case at bar was the assertion that as a member of LICOA Agency, he still owed for stock issued by the corporation. The trial and circuit courts agree that that assertion is well founded as against the other partners (Cir. R. 19, 20). It is well settled that a corporation is without power to validly release an obligation to pay for stock without the consent of all stockholders. *Morgan v. Struthers,* 131 U.S. 246, 33 L.Ed 132, 9 Sup. Ct. 264; 18 C.J.S. p. 1382, Corporatoins sec. 663; *Enright v. Heckscher* (CCA 2, 1927) 240 F. 683, 877; *Willis v. Nehalem Coal Co.,* 52 Ore. 70, 96 P. 528, and cases cited, cf. Section XII, Article 5, Utah State Constitution; *Henderson v. Turngren* (1894) 9 Ut. 432, 35 P. 495; *Rolapp v. Ogden & N.W. R.R. Co.,* 37 Ut. 540, 110 Pac. 364.

The plaintiff's motion to enjoin the purported release obtained in the state court was filed on the authority of *Wells Fargo and Co v. Taylor* (1920) 254 U.S. 175, 75 L.Ed. 205, 41 Sup. Ct. 93; *Breswick vs. Briggs,* 135 Fed. Supp. 397. The Circuit Court adopted the view of the trial court that notwithstanding the rule of the *Wells Fargo* case, and even assuming that the corporation was without power to make the agreement between Pugsley and the corporation, that Pugsley could not be enjoined from entering the defense.

Reasons for Granting the Writ

1. The Circuit Court decided a federal question in a manner conflicting with applicable decisions of this court in that it held that a district court was without power to enjoin the interposition as a defense an order inequitably obtained in the state court. The holding conflicts with *Wells Fargo Co. vs. Taylor*, (1920) 254 U.S. 175, 65 L.Ed. 205, 41 Sup. Ct. 93.

2. The Circuit Court decided a federal question in a way in conflict or probable conflict with applicable decisions of this court in that it ignored the facts found by the trial court in violation of Rule 52(a) of the Rules of Civil Procedure promulgated by this court.

3. The rule of the Circuit in this case conflicts with the rules of three other Circuit Courts and the Court of Appeals for the District of Columbia on the same question.

4. The Circuit decided important state questions in a way in conflict with applicable state law.

5. The Circuit in this case so far departed from the accepted and usual course of judicial procedures in failing to rule upon the facts and misapplying the law as to call for the exercise of this court's supervisory powers.

ARGUMENT

1. The Circuit Court of Appeals decided a federal question in a manner conflicting with applicable decisions of this court in that a district court was without power to enjoin the interposition of a defense, an order inequitably obtained in the state court. The holding conflicts with *Wells Fargo vs. Taylor* (1920) 254 U.S. 175, 65 L.Ed. 205, 41 Sup. Ct. 93. In the

Wells Fargo case the court held that a United States District Court had the power to enjoin the interposition of a judgment in the state court under circumstances that rendered the enforcement of said judgment contrary to recognized principles of equity and standards of good conscience. The *Wells Fargo* principle was applied by one district court in *Breswick vs. Briggs*, 135 Fed. Supp. 397, where it was held that a district court had the power to enjoin individual defendants from asserting as a defense in the federal court action any judgment or decree obtained in the state court where the plaintiff in a derivative stockholders' action pending in the state court was not a party to the federal court proceeding.

In the case at bar, defendant Pugsley interposed as a defense an order confirming a stipulation in the state court in an action between Pugsley and the defendant corporation. Plaintiff contended that not only was the order inequitably obtained, but that the corporation was without power to enter into the stipulation on which it was based. The trial court held that the agreement was in the nature of a covenant not to sue but that it barred plaintiff from maintaining this action. The Circuit held in effect that whether the corporation had the power to enter into the stipulation, and even if the stipulation was unconscienable, the District Court was without power to enjoin defendant Pugsley from interposing the order as a defense in this action. In effect, it upheld the ruling of the district court denying the power which this court held existed in *Wells Fargo and Co. v. Taylor*. Whether a district court has the power to enjoin a party from taking a benefit unlawfully if not fraudulently obtained in a state court presents a substantial, important federal question.

2. The Circuit Court decided a federal question in a way in probable conflict with applicable decisions of this court

in that it ignored the facts founded by the trial court in violation of Rule 52(a) of the Rules of Civil Procedure.

Rule 52(a) of the Rules of Civil Procedure provides that "Findings of Fact shall not be set aside unless clearly erroneous." In the case at bar the trial court based its decision on granting the motion for Summary Judgment as to the first cause of action and decided the second cause of action upon factual considerations which were undisputed. The Circuit, in reversing the trial court, based its decision upon a set of facts in complete conflict with the facts before the trial court. So far did the Circuit disregard the requirements of Rule 52(a), that it is reasonable to characterize its decision as being based upon a hypothetical state of facts not before the court. The fine rules prescribed by this court and to the Circuit with respect to this question as to whether the trial court's findings were "clearly erroneous" were entirely disregarded. Citation of authority for the proposition that Rule 52(a) is applicable appears to be superfluous. Examination of the relevant factual issues involved in the lawsuit clearly demonstrates that the Circuit failed to adhere to its requirements.

(b) The issue as to whether the mutual and stock companies were different legal entities.

On the first cause of action plaintiff's theory was that at the time the corporation came into existence as a stock company, the defendants' conduct violated duties they owed to the newly created legal infant. The discussion of court and counsel on the motion for summary judgment at the pretrial conference clearly indicates that the court was proceeding on the theory that the stock corporation was being brought into existence as a new legal entity at the time of the conversion from a mutual company (R. 196-197). In his ruling on the

second cause of action the trial judge clearly stated that the mutual and stock companies were separate, distinct legal creatures; that the mutual company was insolvent and could not pay the LICOA partnership its advances and that a tort resulted from causing the stock corporation to pay such advances without disclosing the obligations of the mutual company to the stock company. In accordance with Rule 56 of the Rules of Civil Procedure plaintiff is entitled to the presumption of facts indulged by the trial court in his ruling on the summary judgment motion. On the second cause of action, the LICOA group filed a Statement of Points on Appeal to the Circuit (R. No. 5977 and 6000 in the Circuit filed September 12, 1958, pg. 3). There was no question raised in such statement to the effect that the trial judge erred in holding that the mutual and stock companies were separate legal creatures or that such factual determination was not supported by the record. Yet the Circuit found that the mutual and stock companies were the same entity (Circuit Record, especially pages 17, 18). The only support for this conclusion which the Circuit can find from the record is that the LICOA group intended to convert the mutual company to a stock company at some future time if the requirements of the escrow agreement were satisfied and that such intention existed from the beginning of the operations of the mutual company (Circuit R. 17, 18), but even the chief malefactor, Bullard, the president and guiding hand of the enterprise, testified that the stock company could not come into legal existence until it could issue stock (R. 409). That could not occur until the escrow agreement was satisfied (R. 106-108; see Ex. F at 108-110).

Insofar as the determination as to whether the stock and mutual companies were different entitles is a question of fact

or a mixed question of fact and law, the Circuit's decision misses the entire point of the case and is based on a hypothetical premise.

(b) The question as to negligence or fraud.

Plaintiff's theory on both causes of action was that the individual defendants were guilty of negligence or in failing to make appropriate disclosures at the time the stock corporation took assets out of escrow and came into being as a legal entity. The trial court, in its ruling on the first cause of action, assumed that plaintiff's allegation in respect to violation of duties of defendants were true and that the defendants were guilty of fraud, negligence or other misconduct (R. 201). The basis of the ruling of the trial court on this cause was that in the trial judge's opinion, the corporation did not have the right to maintain the action, because it had not been damaged (R. 200, 201). It is to be observed that insofar as plaintiff claimed that the wrongdoing of the defendants consisted of issuance of stock to LICOA Agency members, such assertion is involved in both causes of action and the trial court held on the second cause of action that such conduct constituted fraud. Insofar as the court treated the question of negligence at all, it said in substance that "counsel for plaintiff overlooks the carefully worded qualifying language of the June 22 letter upon which liability was based" (Circuit R., 14). An analysis of that letter appears in Appendix 4 to this petition. The "careful wording" referred to by the Circuit is precisely what makes it wholly misleading. It is submitted that failure of the Circuit Court to accord plaintiff the benefit of the findings and assumptions to the effect that there was negligence or fraudulent misconduct is a patent violation of Rule 52(a) of the Rules of Civil Procedure.

(c) The question as to whether the stock corporation received benefit from the LICOA Agency advances.

The LICOA partnership stipulated that all advances by it went to the mutual company. There were no advances after operations by the stock corporation (R. 100). The trial court found that in June, 1953, immediately prior to the conversion, the mutual company was hopelessly insolvent; that it could not repay these advances, and that the fact of such insolvency and the fact that the advances were claimed by the partnership to have been made to the mutual company was not disclosed to the stock company (R. 139, 140). It is to be observed that a close analysis of the affairs of the mutual company discloses that its total assets were only of the value of $7,488.74, while its liabilities were in the amount of $52,688.99, approximately 7½ times its assets (see Appendix 2 attached). While the LICOA Agency claimed to have advanced to the mutual company assets of a value of $28,033.17, this was four times the amount of assets which the mutual company had at the time of the conversion. Yet the Circuit Court held that the stock company received the benefit of the LICOA Agency advances, and notwithstanding that these advances were not even disclosed as a liability to the stockholders, and notwithstanding the fact that the conversion procedures necessarily resulted in the stock company's payment of obligations of more than $17,000.00 in cash, it suffered no damage. The Circuit held that the defendants as fiduciaries to the corporation they were promoting had no duty to disclose the fact that its assets were being used to discharge the obligations of the mutual company to which they were also fiduciaries. The Circuit held that they were justified in ignoring the fact that they were dealing in a dual capacity on the ground that they did not observe the distinction between the two legal

entities. They were justified in doing what they did, said the Circuit, because they did it.

Except that the Circuit's rulings in misconstruing the facts involved the crux of the plaintiff's theory and the theory of the trial court, violation of Rule 52 (a) would hardly justify the intervention of the court. But in the case at bar, violation of the rule is so shocking and the error of the Circuit so flagrant that plaintiff is compelled to address this court for its review. This court has held, in applying Rule 52(a) to its own deliberations, that a reviewing court should not disturb findings of fact of a trial judge unless they are clearly erroneous. *United States v. Yellow Cab Company* (1949) 338 U.S. 338, 94 L.Ed. 150, 70 Sup. Ct. 177; *United States v. Oregon Medical Society* (1952) 343 U.S. 326, 96 L. Ed. 978, 72 Sup. Ct. 690. When a Circuit Court violates the rule; when it goes farther and assumes critical facts which are absolutely unsupported by the evidence, a litigant has no recourse except to petition this honorable court for correction of the error.

3. The rule of the Circuit Court in this case is in conflict with the rules announced by other Circuit Courts of Appeals on the same question.

Plaintiff asserted here, and the district court held, that certain individual defendants violated duties as fiduciaries to a stock corporation which came into existence as the result of the "conversion" of a mutual company.

The Circuit Court in the case at bar ruled as a matter of fact and law that the mutual life insurance company which was owned by and operated for the benefit of policyholders, and a stock insurance company owned by stockholders were the same legal entity. Such premise and ruling permeates the opinion of the court below and is the only theory upon which

the decision can be rationalized. The Second, Third and Sixth Circuits and the Court of Appeals for the District of Columbia have all held in varying circumstances that a mutual company and a stock company were two separate and distinct legal entities with wholly different legal characteristics.

Equitable Life Assur. Soc. v. Bowers (CCA 2 1937) 97 F.(2d) 687, 689; Driscoll v. Washington County Fire Ins. Co. (1940, CCA 3) 110 F(2d) 485, 490; Ohio Farmers Indemnity Co. v. Commissioner of Int. Rev. (CCA 6, 1950) 108 F(2d) 665, 667; Hutchins Mutual Ins Co. v. Haven (1939 D.C. Ct. of App.) 105 F(2d) 53, 57.

In *Equitable Life Insurance Co. v. Bowers,* (CCA 2, 1937) 97 F(2d) 587, 689, the Second Circuit held that the time of the conversion of a mutual company to a stock company is the time when the stockholders were issued stock and thereby obtained the control of the company. This is precisely the rule contended for in the case at bar. The Tenth Circuit entirely disregarded the decision of four other courts of equal rank and held that a mutual company which operated for two years as a separate and distinct legal entity was the same entity as a stock corporation to which it was converted in June, 1953. Upon this premise, the court concluded that the fiduciaries who failed to disclose the mutual company's insolvency to the stock company, thereby causing the stock company's assets to pay the bills of its predecessor, were not guilty of a tort.

4. The Circuit decided important state questions in a way in conflict with applicable state law:

(a) The Circuit held that the mutual company and the stock company were the same legal entity. The Utah statutes clearly distinguish between the rights, obligations, ownership and operation of mutual insurers and corporations en-

gaged in the insurance business. Chapter 9 of Title 31 Utah Code Annotated, 1953, entitled "Domestic Mutual Insurers" provides in detail for the organization and operation of mutual companies. Section 31-9-12 provides in part:

> "1. A domestic mutual insurer is owned by and shall be operated for the exclusive benefit of its members.
> "2. Each member shall be entitled to one vote in the election of directors and on matters coming before corporate meetings of members, subject to such reasonable minimum requirements as to duration of membership and amount of insurance held as may be made in the insurer's by-laws. If such member be a minor, the vote shall be vested in the parent or legal guardian of such minor."

Subsection 3 in express terms gives members the same rights and relationship to the mutual company as stockholders have toward a corporate stock insurer.

Sections 31-9-18 and 31-9-19 provide for assessments on members in the event of deficiency of assets and for the contingent liability of members in certain circumstances for the obligations of the mutual company. These sections are set out in Appendix 1 attached to this petition.

Section 31-9-33 provides that upon liquidation of a mutual insurer, its assets after discharge of its obligations shall be distributed to its members. The section appears in Appendix 1 to this petition.

Section 31-9-32 provides that before a mutual company is converted to a stock corporation, the members of the insurer must receive a pro-rata offering of capital stock and the conversion must be approved at a meeting of the members.

In all of these sections the state statute distinguishes between mutual and stock companies.

Chapter 6 of Title 1 of the Utah Code governs the organization and existence of corporate domestic insurers. Section 31-7-1 provides: "The laws of this state related to private corporations, except where inconsistent with the express provisions of this Code shall govern the corporate powers, duties and relationships of incorporated domestic insurers." Stock insurers in Utah, as elsewhere, are operated by directors elected by stockholders and stockholders are the owners of the company and ultimately receive its benefits or take its losses.

The distinction between a mutual and stock company was clearly recognized by the state officials in the case at bar. Under the jurisdiction of the insurance commissioner, the promoters of the stock corporation agreed that the assets collected through the sale of stock would be held in escrow until license to do business as a stock corporation was obtained and until a minimum of $200,000.00 in assets was available for obtaining the license. Satisfaction of these requirements was a condition precedent to the existence of the stock company. On the other hand, the mutual company was already in existence: it had a license to do business; it was operating; its policyholders and creditors had to look to its assets for satisfaction of claims.

Thus, the decision of the circuit in holding that the mutual and stock company were the same entity disregards both the state statute and its interpretation by the state officials.

(b) The Circuit Court failed to apply the rule of *Old Dominion Copper and Smelting Co. v. Bigelow*, 203 Mass. 159, 89 N.E. 193.

The trial court held that while there was no decision precisely in point, the Utah Supreme Court would undoubtedly follow the rule of the *Bigelow* case. The Circuit Court stated:

"The trial judge from the breadth of his experience in Utah believes the state will follow the *Bigelow* rule. We shall accept his view as to the applicability." While thus giving lip service to the rule, the court refuses to apply it in the case at bar. The Circuit Court held that "*Bigelow* applies when the promoters make secret profit." Here the promoters did not make profit." Plaintiff contends and the trial court held that the principle of the *Bigelow* case applied not only where the promoters made a secret profit but where they recoup a secret loss at the expense of the company they brought into being. In the *Bigelow* case the corporation was held to be entitled to recover the difference between the fair value of the assets for which it was caused by the promoters to exchange its stock and the par value of the shares. In that case the assets were overvalued. In the case at bar the corporation was caused to assume the obligation of a mutual company whose liabilities exceeded its assets by substantially $45,000.00. The stock of the corporation whose legal existence commenced with the taking of the assets out of escrow was caused to pay creditors of the mutual company the cash to the extent of in excess of $17,145.08 and to issue stock to the balance of its creditors who were the individual defendants in this action the sum of $28,033.17. The stock corporation received absolutely nothing in exchange for the stock and cash which the promoters caused the stock company to pay to the mutual company creditors. The trial court permitted recovery to the extent of the $28,033.17 which the corporation was caused to issue in stock to the individual defendants but denied recovery with respect to the cash. The principle of the *Bigelow* case applied to the facts as were actually presented here would result in a judgment in at least the sum of $45,180.25 plus interest at the legal rate provided by the Utah statute.

(c) The Circuit Court failed to apply the Utah law with respect to the duties of fiduciaries.

The rule in Utah, as indeed universally, is that a promoter and a director stands in a fiduciary relationship to the corporation being promoted and that he is required to exercise honesty, fairness and objectivity in his dealings with it. Fletcher states the rule in Cyclopedia Corporation, Vol. 1, page 617, as follows:

> "Perfect candor, full disclosure, good faith, in fact the utmost good faith, the strictest honesty are required of promoters, and their dealings must be open and fair or without undue advantage taken."

The rule is summarized at 18 C.J.S., pg. 551, Corporation, Sec. 152.

> "It is incumbent upon a promoter who derives an advantage or profit not enjoyed by other stockholders, to see that the corporation is represented by an independent board of directors, and to make a full disclosure of his interest and all pertinent facts."

The trial court stated that *Hayward vs. Leeson,* 176 Mass 323, 57 N.E. 565, was controlling; thus since notice of the promoters' self-interest was not given to the stockholders placing their money into the enterprise the corporation could recover damages. In the *Hayward v. Leeson* case the court said:

> "The persons to whom the promoters owed the duty which they owe by reason of their fiduciary relation are the persons who put their money into the enterprise at the invitation of the promoters; that is to say, the future stockholders. It is to the future stockholders that the promoters must make the disclosure . . . "

Old Dominion Mining and Smelting Co. v. Bigelow. 203 Mass. 159, 89 N.E. 206, characterizes the duty of the promoter as follows:

> " . . . on principle apart from authority, . . . The starting point is that a promoter is a fiduciary to the corporation. To use the words of Lord Cairns in Erlanger v. New Sombrero Phosphate Co., 3 App. Cas. 1218, at page 1236: 'Promoters have in their hands the creation and moulding of the company. They have power to define how and when and in what shape and under what supervision it shall start into existence and begin business.' The corporation is in the hands of the promoter like clay in the hands of the potter. It is to this person, absolutely helpless and incapable of independent initiative or uncontrolled action, that the promoter stands as trustee." . . . "

It is to be observed that even the *Lewisohn* case, often compared with the *Bigelow* case (Annotated 85 A.L.R. 1283), would not deny recovery in a case such as this. Mr. Justice Holmes said there:

> "If there had been innocent members at the time of the sale, the fact that there were also guilty ones would not prevent a recovery . . . "

Old Dominion Mining and Smelter Co., v. Lewisohn, 210 U.S. 206, 28 Sup. Ct. 634, 52 L.Ed. 1025 at 213 U.S. Reporter, 1030 L.Ed.

He undertook to distinguish *New Sombrero Phosphate Co.*, L.R. 3 App. Cases 1218, on this very ground stating that in the *New Sombrero* situation, "As it is put in 2 Morawetz, Private Corporations, 2nd Edition, Section 292, there was really no company until the shares were issued." The case at bar presents the very situation where the innocent stockholders received their shares coincident with the defendants' causing the corporation to assume the liability to issue shares to themselves without any consideration.

Other leading cases applying the same principle are

Dickerman v. Northern Trust Co., 176 U.S. 181, 20 Sup. Ct. 311, 44 L. Ed. 423; *Taylor v. Citizens Oil Company* (Ky. 1918), 206 S.W. 644, and *McCandles v. Furlaud* (1935) 296 U.S 140, 80 L.Ed. 121, 56 Sup. Ct. 41.

The Utah statutes give sharp emphasis to the theory that directors, officers and agents of insurers have the responsibility of dealing fairly with corporate insurers (31-27-13, U.C.A. 1953), and prohibiting such persons from disseminating false financial information (31-27-3, U.C.A.) or making misleading representations concerning insurers' affairs (31-27-4, U.C.A. 1953). Sec. 31-1-8 of the Utah Code Annotated, 1953, recites that " . . . the business of insurance is one affected with the public interest requiring that all persons be actuated by good faith, abstain from deception and practice honesty and equity . . . Upon the insurer . . . and their representatives rests the duty of preserving inviolate the integrity of insurance."

At the time plaintiff claims that defendants violated their duties to the corporation, the mutual company owed some of them, the LICOA group, $28,033.17 plus, as they claimed, amounts due under an illegal agreement providing for the payment of commissions. The mutual corporation's liabilities exceeded its assets by $45,180.25.

No one has yet suggested in this lawsuit how these promoters could pay themselves and discharge the obligations of the mutual company at the same time, except by representing to the Insurance Commissioner that enough assets were in escrow to satisfy the requirements of the escrow agreement. Can anyone except the credulous suppose that the representation that $214,780.00 had been accumulated was accidental? The trial court held, and it is undisputed, that the personal advantages to be gained by the promoters through

the completion of the conversion procedures were not disclosed to the stock corporation or any stockholder or the Insurance Commissioner.

The Circuit says that "the company" obtained a license to do business as a stock company and states that since the license was an advantage to it, it is in no position to complain. But the only practical purpose of that license was to enable the promoters to reap a personal advantage through payment of the mutual company's obligations to them which otherwise would remain unpaid.

The Circuit seems to feel that the obligations of promoters do not exist inasmuch as the new corporation arose out of a kind of reorganization procedure. That view is contrary to law.

Fletcher's Cyclopedia Corporations, Perm. Ed. Vol. 15, pg. 546, Sec. 7325, states in part as follows: "The promoters of a reorganization stand in a relationship of trust to the new corporation and will be held liable to it for any acts in violation of such trust." The Second Circuit held in *Edenborn v. Sim* (CCA 2 1913) 206 Fed. 275, that where there is a constructive fraud by a promoter in a reorganization proceeding, the remedy is for damages in a suit by the reorganized company and that the new company is the proper party plaintiff. It is important to observe that at page 278 the court stated explicitly that the damage is for the secret profit of the defendant promoter *or* the damage to the company. In *San Leandro Canning Co. v. Perillo, et al.* (1927) 84 Cal. App. 627, 258, p. 666, a corporation plaintiff sued certain organizing directors for the issuance of stock in plaintiff corporation. The individual defendants were directors of a constituent company which had been reorganized into the plaintiff corporation. They were also directors of the plaintiff corporation at the

time of its reorganization. The value of certain assets of the old corporation was only $20,000.00 and the individual defendants caused the plaintiff to accept them at a value of $135,000.00, which was issued in stock. The court held that the plaintiff corporation was the proper party to bring the action, and that an action lay against the individual defendants for such misconduct. The case clearly demonstrates that the question is not necessarily the amount of "secret profit" of the malefactors, but the amount of loss of the corporation. That the directors in a reorganization proceeding, whether it is in the nature of a merger or any other type of consolidation, have a duty to inform the stockholders with respect to the full facts, including their interest and that they are liable for undervaluation or overvaluation of assets appears to be undisputed except for the ruling of the Circuit in the case at bar. See 19 C.J.S. 1374, Corporations, Section 1613. See also *Garrett v. Reid Cashion Land & Cattle Company*. 270 P. 1044, 34 Ariz. 245. Rehearing denied 272 P. 918, 34 Ariz. 482.

Whether promoters of a new stock corporation or simply promoters of the reorganization, since these defendants were at the same time directors of the mutual company and the stock company and they had a personal interest in the reorganization proceeding and the stock corporation was damaged as a result of failing to disclose the full facts, they are liable for damages. The very minimum amount of those damages must be the amount of the stock corporation's assets used to discharge the obligations of the mutual company.

The rule of the Circuit in the case at bar is obviously at variance with the considered opinions of highly respected authorities in comparable factual situations. There is, of course, no Utah case directly in point on the facts, but unless

the judiciary is willing to exercise as much ingenuity and thoughtfulness in striking down schemes and concoctions whereby promoters impose upon their *cestui que trusts* as the promoters do in concocting the schemes, investors are left little protection against the unscrupulous.

It is submitted that *Erie Railroad vs. Tompkins.* (1938) 304 U.S. 64, 82 L.Ed. 1188, 58 Sup. Ct. 817, 114 A.L.R. 1487, requires that the decision of the Circuit be reversed in the case at bar.

5. The Circuit in this case so far departed from the accepted and usual course of judicial procedures in failing to rule upon the facts as presented and misapplying applicable law as to call for an exercise of this court's power of supervision.

No doubt exists that the great public questions which require the attention of this court deserve and receive some degree of priority in determining the cases which are to be accepted for its deliberations. Question 1 referred to in this petition as it involves the relationship of federal and state judical powers and procedures merits the attention of the court in its own right as an important problem in federal-state judicial relationships.

Questions 2 and 3 may have less wide-spread public interest. They too, however, on their own merits, deserve the attention of this court. When a great Circuit Court wholly misses the point in a case involving hard private law as distinguished from public law, there is no other judicial body to right the injustice except this court.

The entire Anglo-American concept of judicial administration is founded upon application of "law" to "facts." How

can there be greater failure of the judicial process than disregard of relevant facts or assumption of facts? The instant case involves more than "weighing the evidence" in the accepted sense of the phrase; it involves a decision upon facts not in evidence at all.

It may well be that the volume of litigation in the public law field deserves the full time of a judicial body of last resort. But until such time as this court is relieved of its responsibility to supervise the circuit courts and in effect to compel compliance with the requirements with the Rules of Civil Procedure and the rule of *Erie R. R. Co. v. Tompkins* (1938) 304 U.S. 64, 82 L.Ed. 1188, 58 Sup. Ct. 817, 114 A.L.R. 1487, it is submitted that the court has the same responsibility to hear the kind of a case presented by this petition as one approved by the Solicitor General of the United States or a national trade association. When a Circuit disregards the substantive law of a state and the rules promulgated by this court, no remedy exists except through this court. The decision of the Circuit Court cannot be allowed to stand if law is to prevail in the case at bar.

Respectfully submitted,

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APPENDIX A

Opinion of the Court of Appeals, Tenth Circuit, filed March 16, 1959.

Before *Huxman, Murrah,* and *Breitenstein,* Circuit Judges.

Breitenstein, Circuit Judge.

These three interrelated appeals arise from a stockholder's derivative suit in which federal jurisdiction is based upon diversity of citizenship. Bergeson, the plaintiff below, sued as a stockholder in, and for the benfit of, Life Insurance Corporation of America.[1]

The complaint sets out two claims. The first is directed against Bullard, Rich, Wright, Wirthlin and Pugsley,[2] as officers and directors of the company and as members of a partnership known as LICOA Agency Company, and against Birrell, Zimmerman and Thomas,[3] as partnership members of an accounting firm. It charges that the defendants improperly and negligently caused the company to come into existence with an impaired financial condition.

The second claim goes only against the members of the LICOA group and alleges that they improperly and in violation of their fiduciary duty as corporate officers and directors issued company stock without consideration.

Defendant Pugsley, a member of the LICOA group, raised the defense of res adjudicata and obtained a summary judgment in his favor on each count.

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[1]Hereinafter Bergeson, the appellant in No. 5914 and one of the appellees in Nos. 5700 and 6000, will be referred to as a plaintiff or by name. Life Insurance Corporation of America, one of the appellees in each of the three cases, will be referred to as the company.

[2]These defendants will be referred to by name or collectively as the LICOA group.

[3]These defendants will be referred to collectively as the accountants.

The motions of all defendants for summary judgment on the first claim was sustained on the ground that there was no showing of any damage to the company.

The issues in connection with the second claim were presented to the court for determination on the basis of a stipulation of facts, answers to interrogatories, responses to requests for admission, depositions, and pre-trial conference statements. The court held that the members of the LICOA group, except Pugsley, were jointly and severally liable for the market value of 2,000 shares of stock issued to the LICOA partnership, fixed the market value of the stock at $20 per share, and entered judgment against these defendants in the sum of $40,000.

No. 5914 is an appeal by plaintiff Bergeson from the judgment in favor of Pugsley on both claims and in favor of all defendants on the first claim.

No. 5977 is an appeal by defendants Bullard, Wright and Wirthlin, members of the LICOA group, from the adverse judgment on the second claim. It was filed for protective purposes as defendant Rich, the other group member against whom the judgment was entered, had moved for a new trial and thus stayed the appeal time as to him.

In No. 6000 defendants Bullard, Wright, Wirthlin and Rich all join in an appeal from the adverse judgment on the second claim. This appeal was taken after Rich's motion for new trial had been denied. The only difference between No. 5977 and No. 6000 is that Rich is a party to No. 6000 but not to No. 5977.

The twice supplemented record in these appeals is lengthy and complex. The disorderly method of presentation is so

coupled with the inclusion of extraneous material and the omission of relevant material that he who would find a pertinent fact must travel an intricate labyrinth, the paths of which lead more often to confusion rather than understanding. All this is in a case in which, so far as we can ascertain, there is not a single disputed factual issue.

The basic facts are relatively simple. Sometime in 1951 defendants Bullard, Wright, Wirthlin and three others, who are not parties hereto, formed a partnership known as LICOA Agency Company.[4] Prior to the events with which we are concerned, one of the three others sold his interest to defendants Pugsley and Rich, each obtaining one-half thereof. The partnership, in April 1951, caused the organization, under Utah law, of a mutual benefit life insurance company known as Life Insurance Corporation of America, the company for whose benefi, this derivative suit was brought. The defendant members of the LICOA partnership were, at varying times, officers and directors of the company so organized. To assist the new company in getting started the partnership advanced to it about $23,800 and supplied furniture and equipment of the value of $4,145. The partnership was to receive overriding commissions on all insurance written by the company. The company engaged in the business of a mutual insurer but its operations were not financially successful.

In May, 1952, the members of the company voted to change from a mutual company to a stock company and adopted amendments to the articles of incorporation to effectuate this change. A permit was obtained by the company from the Utah Securities Commission to make a public offering of its stock and, under the direction of the Utah Insurance Commissioner, an

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[4]Hereinafter referred to as the partnership.

escrow agreement was made with the Utah Savings and Trust Company under which the proceeds from the sales campaign were to be put in escrow. A campaign was then undertaken to sell 20,000 shares of stock at $20 per share. Subscription notes were used which commonly provided for installment payments with no right to collect deficiencies. In the event of default the subscriber would receive only the stock for which he had paid at the $20 offering price and the company could not maintain an action to recover the unpaid installments.

The company employed an accounting firm in which defendants Birrell, Zimmerman and Thomas were partners. The accounting services were performed principally by one McGee who was joined as a defendant but dismissed for lack of service. On June 22, 1953, the accountants made a letter report to the company on its financial condition and therein showed assets in the amount of $214,780. This report was furnished to the Utah Insurance Commissioner who, on July 7, 1953, authorized the company to do business as a stock insurance company and also authorized the release of the escrow. The company then began business as a stock insurer.

The partnership, LICOA Agency Company, was terminated except for the distribution of assets as of January 31, 1954, and then had as its only asset a claim against the company on account of the cash advanced, the equipment furnished, and the claimed overriding commissions. On or prior to March 25, 1954, the exact date appearing nowhere in the record, the directors of the company approved the issuance of company stock to the partnership in satisfaction of the claim asserted by the partnership against the company.

In March, 1954, the company submitted its annual report to the Utah Insurance Commissioner who, after examination,

disallowed as admitted assets items totalling $144,062.82 and found that with such disallowance the capital of the company was impaired. The company was given time to make good the deficiency and in October, 1955, a reorganization was effected. Bankers Life and Casualty Company, an Illinois corporation, put $200,000 into the company for approximately 90% of its stock. Stock outstanding before the reorganization was exchanged for new stock in the ratio of one share of new stock for each 13.5334 shares of the old stock.

In May, 1953, plaintiff Bergeson purchased 83 shares of company stock for $1,660. Upon the reorganization these 83 shares were voluntarily exchanged for 6.1334 shares.

We are not impressed with defense arguments that the requirements of Rule 23(b), F.R.C.P., governing secondary actions by shareholders, have not been satisfied. The trial court found to the contrary and we agree. The defense of laches was interposed by certain defendants and while the trial court recognized some merit in the defense it made no express finding thereon. The defense of laches is primarily addressed to the trial court.[3] In the absence of a trial court finding we have carefully examined the record and are convinced that the action is not barred by laches.

The plaintiff's basic contentions in his first claim are that the LICOA group defendants have breached a fiduciary duty which they owed the company as promoters, directors and officers, and that the accountants have breached a similar duty which is claimed to have arisen from the alleged fact that their partner McGee was a promoter and his responsibility is theirs.

Corporate officers and directors have a fiduciary or quasi fiduciary relationship to a corporation which requires them to

[3]Standard Oil Company v. Standard Oil Compan., 10 Cir., 252 F.2d 65, 76-77.

act loyally and in good faith without assuming any position in conflict with the interests of the corporation.[6] While the responsibility of promoters is not so clearly defined, they too must act fairly and honestly in their dealings with the corporation.[7] This fiduciary duty is said to have been breached by the misconduct of the defendants relating to the financial condition of the company and resulting in the company securing authorization to act as a stock insurer and thereafter acting in that capacity without the required capital.

Utah law provides that a stock insurer transacting life insurance business must have a minimum capital of $100,000 and a minimum surplus of $25,000.[8] These minimum requirements are for the protection of the public. The company had no right to engage in the life insurance business as a stock insurer unless the requirements were satisfied. The fact that it had no such right does not mean that its promoters, directors or officers or anybody else is under any duty to supply it with assets sufficient to meet such requirements.

The objective of the company was to qualify as a stock insurer. To obtain the required financing, the officers and directors instituted a stock sale campaign and assembled items which were held out as assets. A report showing the claimed assets was presented to the insurance commissioner. He granted the necessary authority. If the assets were not sufficient, the permit should not have been granted. However, it was granted and the corporate objective attained. If, as argued, the assets did not meet the minimum requirements the wrong was to those members of the public who thereafter dealt with the company. The company has lost nothing. The fact that it may have gained

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[6]19 C.J.S. Corporations § 761, pp. 103 and 107.
[7]Cf. Davis v. Las Ovas Company, Incorporated, 227 U.S. 80, 86.
[8]Utah C.A. 1953, § 31-11-1.

something to which it was not entitled does not lead to the conclusion that it was thereby deprived of anything. The company received a benefit, the grant of the desired authority. The detriment, if any, was suffered by others.

Great emphasis is placed on the improper inclusion of items as assets and on the improper valuation of assets. Such errors did not injure the company in any compensable sense. Neither mistakes nor misstatements in classification or valuation deprived the company of anything. The property classified and valued was still there. Whatever harm might have resulted to stock purchasers, policyholders or creditors was not a company loss. If the state officials considered that they had been deceived, they could have taken appropriate steps to revoke the authority but those steps were never taken and ultimately corporate reorganization, which admittedly met the Utah requirements, was attained.

Plaintiff's counsel urges that there was misconduct in first asserting value in the subscription notes and later acknowledging that they had no value. Here again the company lost nothing. The notes were not enforceable and the state officials knew it, yet the authority was granted. Later the state officials determined that the notes were without value and the officers and directors wrote them off as assets. The situation may cause one to lift a querulous eyebrow but it does so because the company received a benefit, not because the company suffered any detriment.

Counsel says that the defendants in the LICOA group violated a fiduciary obligation by not disclosing to the company its true financial condition. A corporation necessarily acts vicariously. It is elementary that a corporation can acquire

knowledge only through its officers and agents.[9] Their knowledge is the knowledge of the corporation.

The liability of the accountants is said to arise from the fact that one of their partners, McGee, was a promoter of the company and that their June 22, 1953, report on the company's financial condition was prepared negligently and contrary to accepted accounting practices. McGee was not a promoter of the company. It was in existence as a mutual insurer long before McGee's employment as an accountant. In his severe attack on the June 22, 1953, report counsel for plaintiff overlooks the carefully worded qualifying language thereof. But even if that report did contain an improper inclusion of assets, exclusion of liabilities and valuation of assets, there is no showing of detriment to the company. The report was used by the company to obtain the authorization which it sought.

The only other misconduct charged in the first claim relates to the issuance of corporate stock to the LICOA partnership without consideration. This action is the specific basis of the second claim. It is sufficient to say here that such conduct did not affect the attainment of the corporate objective to secure authority to act as a stock insurer.

In a derivative action such as this the plaintiff must maintain a claim not for himself or any stockholder or any creditor but solely for the corporation.[10] This he has failed to do. The fundamental theory of the first claim, that the corporation was

[9] Mary Jane Stevens Co. v. First Nat. Bldg. Co., 89 Utah 456, 57 P.2d 1099, 1122.

[10] Koster v. Lumbermens Mutual Casualty Co., 330 U.S. 518, 522; Arn v. Dunnett, 10 Cir., 93 F.2d 634, 636, cert. denied 304 U.S. 577, distinguished but not reversed by San Juan Uranium Corporation v. Wolfe, 10 Cir., 241 F.2d 121, 123; cases collected in dissenting opinion of Judge Phillips in Amen v. Black, 10 Cir., 234 F.2d 12, 31-32, notes 8 and 9; 19 C.J.S. Corporations § 821, p. 226; 13 Am. Jur., Corporations, § 461, p. 506.

damaged by acts and omissions of the defendants which resulted in its authorization to act as a stock insurer without the capital and surplus required by Utah law, is wholly fallacious. Whatever improprieties there may have been, the result was not a legal injury to the corporation. If stock purchasers, policyholders or creditors were injured by the misconduct of the defendants, the remedy lies in appropriate actions by them. We agree with the trial court that there may be no recovery on the first claim. This conclusion renders it unnecessary to consider separately the special defenses asserted by the accountants.

The basis of the second claim is that the defendant members of the LICOA group caused the corporation to issue stock to the LICOA partnership without any consideration passing to the company for such stock. The question as to whether a corporation can recover from promoters who controlled it the value of stock issued to them in exchange for property in excess of its reasonable value, even though the corporation ratified the transaction, has resulted in a contrariety of views which were discussed by this court in San Juan Uranium Corporation v. Wolfe, 10 Cir., 241 F. 2d 121. In that case, arising in Oklahoma, this court accepted the so-called Massachusetts rule,[11] and rejected the rule laid down in Old Dominion Copper Mining and Smelting Company v. Lewisohn, 210 U.S. 206. The trial court, recognizing that there was no Utah case directly in point, held that the decision in Roberson v. Draney, 53 Utah 263, 178 P. 35, indicated that Utah would follow the Bigelow rule and, accordingly, disposed of the case on that basis. We have heretofore applied the Bigelow rule for Oklahoma in the absence of any choice by that state between the Bigelow and Lewisohn rules. The trial judge, from the breadth of his

[11]Old Dominion Copper Mining and Smelting Co. v. Bigelow, 203 Mass. 159, 89 N.E. 193.

experience in Utah, believes that state will follow the Bigelow rule. We shall accept his view as to its applicability.

However, the Bigelow rule is not determinative of the issues presented by the second claim. Bigelow applies when the promoters make secret profit. Here the promoters did not profit. While the members of the LICOA group were the promoters, officers and directors of the company and did authorize the issuance of stock to their partnership, they did so on the basis that there was full consideration therefor. Part of the consideration claimed was cash and property, the value of which is not questioned. The remainder was for services rendered in producing insurance business. The adequacy of the consideration is the sole question. The bookkeeping practices of the company which failed to disclose the liability to the partnership may have misled stock purchasers, state officials, and others but the wrong to such persons was not a wrong to the company.

Plaintiff contends that at the time of the conversion from a mutual insurer to a stock insurer a new corporate entity came into being. While there are important differences between a mutual insurer and a stock insurer,[12] Utah recognizes the right of a mutual company to change to a stock company.[13] The uncontradicted statement of defendant Bullard in his deposition was that the plan of the promoters of the company was to organize a "mutual company, to use that as the basis of the corporation, and then to convert it at a later date to the stock

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[12]Cf. Ohio Farmers Indemnity Co. v. Commissioner of Internal Revenue, 6 Cir., 108 F.2d 665, 667; Hutchins Mut. Ins. Co. of District of Columbia v. Hazen, D.C. Cir., 105 F.2d 53, 57

[13]Utah CA. 1953, § 31-9-32 provides: "No domestic insurer shall hereafter be converted, changed, or reorganized as a stock corporation, unless a prorata offering of all the capital stock is made to all the members of the insurer, and unless such conversoin, change or reorganizaton is approved at a meeting duly called for that purpose." In the instant case there is no claim of non-compliance with the statute.

company." Such plan was recognized in the original by-laws which set up procedures to be followed in the event "the corporate structure is changed to a capital stock insurer." The necessary amendment to effect the change was unanimously adopted by the members. There was no change of either name or officers. The mere amendment of articles of incorpartion does not create a new corporation.[14] This rule has been applied to the reorganization of insurance companies.[15]

The partnership admittedly advanced cash and furnished equipment to the company in the total value of about $28,000. The trial court held that this did not constitute consideration for the stock issue because of the inhibitions contained in the Utah statutes with reference to the borrowing of money by a mutual insurer.[16] Among other things, the Utah law forbids the payment of a loan by a mutual except out of earned surplus. The trial court held in effect that the sums represented by the cash advanced and equipment furnished were loans to the mutual repayable only out of earned surplus, and that as there was no earned surplus at the time of the conversion to a stock insurer the advances were uncollectible from the mutual and did not automatically become a liability of the stock insurer.

Defendant Bullard testified that the original contributions by the partnership found their way into the books of the mutual as contributed surplus "on the understanding that at such time that the mutual corporation became a stock corporation that that would then be issued back to the LICOA Agency

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[14]News Pub. Co. v. Blair, D.C. Cir., 29 F.2d 955, 957; Wright v. Barnard, 248 F. 756, 775; Polk v Mutual Reserve Fund Ass'n, 137 F. 273, 277; 18 C.J.S. Corporations § 84, p. 485.

[15]44 C.J.S. Insurance § 106, pp. 650-651; Fletcher, Cyclopedia of the Law of Private Corporations, Vol. 7, § 3329, p. 907; Burns v. Western Protective Ins. Co., 9 S.W. 2d 676, 222 Mo. App. 1044; Citizens Mut. Fire and Lightning Ins. Soc. v. Schoen (Mo.), 105 S.W.2d 43.

[16]Utah C.A. 1953, § § 31-9-29 and 31-9-30

for stock." This can only mean that the advances were not loans but were in effect stock subscriptions. As there was only one entity, the acceptance of the benefit of these advances carried with it the obligation to issue stock therefor at such time as the corporation was in a position to take such action. To the extent that stock was issued with a market value not exceeding the value of the cash advanced and the equipment furnished it was paid for by the partnership.

The situation is different as to the $12,267 claimed by the partnership under the arrangement for overriding commissions. Utah law provides that an insurer shall not pay to any person who has the power to decide which insurance applications shall be accepted or rejected any compensation related to income upon such risks except upon the net profits therefrom.[17] This provision was violated by an agreement to pay the partnership overriding commissions on all insurance written because members of the partnership were the officers and directors of the company and had the power to accept or reject risks. Their self-interest in the partnership might well impair the ability of those officers, who were partnership members, to distinguish between good and bad risks. The statute may not be avoided by the device of a partnership. It follows that there was a failure of consideration for the stock to the extent that the value of the issued shares at $20 per share exceeded the amount of the cash advanced plus the value of the furniture and equipment.

The LICOA group strenuously contends that the market value of the stock was not $20 per share. On the basis of the meager evidence of value the court found that the market value was $20 per share. This finding is sustained by evidence

[17] Utah C. A. 1953 § 31-7-10.

of some sales of stock at this figures at about the same time as, and after, the stock issuance. Also it is supported by the fact that the members of the LICOA group themselves fixed this as the value of the shares. In these circumstances it cannot be said that the findings by the trial court of the market value is clearly erroneous.

The query remains as to individual liability for the balance due on the stock. The theory of liability because of breach of a fiduciary duty absolves defendant Rich because he was neither an officer nor a director at the time of the stock issuance. The theory of quasi-contract imposes such liability because as a member of the LICOA partnership Rich received the benefit of the stock issued to that partnership. A careful consideration of the confused record presented to us and of the involved reasoning of counsel leads us to the conclusion that in this case the correct theory of liability for the partial failure of consideration is that of quasi contract. To prevent their unjust enrichment the partners must make good the partial failure of consideration. They are jointly and severally liable therefor because they failed to comply with the Utah limited partnership act,[18] and hence are liable as general partners under Utah C.A. 1953, Sec. 48-1-12.

Two defendant members of the partnership assert that by reason of circumstances affecting them they are not liable. Rich bases his contention on the fact that he resigned his office and directorship in the company in September, 1953, and was not a party to the authorization of the stock issuance in 1954. His position would be well taken if liability were imposed on the ground that the defendant members of the LICOA group had breached a fiduciary duty. We have rejected that theory. As

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[18] Utah C. A. 1953, § 48-2-2.

a member of the partnership which received the stock, Rich shares in the partnership liability.

Defendant Pugsley asserts the defense of res adjudicata and obtained a summary judgment in his favor. The basis of his defense is a judgment of dismissal entered on stipulation of counsel by a Utah court on March 7, 1957, dismissing an action brought by Pugsley against the company to recover unpaid director's fees. The judgment states that the action, "together with any possible counterclaims relating thereto," was dismissed with prejudice. The claim here asserted against Pugsley was one which could have been raised by the company as a counterclaim in the state court suit. This is not questioned by the plaintiff. Instead he urges that the company had no right to make the stipulation upon which the judgment was entered without the approval of the stockholders and such approval was never obtained. The point is of no avail as the state court unquestionably had jurisdiction of the parties and of the subject matter and had power to enter the judgment which it did.[19] A judgment of dismissal pursuant to a stipulated settlement is ordinarily a judgment on the merits barring another action for the same cause.[20] No suggestion is made of fraud or collusion. Whatever claim there may be of lack of corporate power in the absence of stockholder action should be addressed to the Utah court. At the most it is a collateral attack on the judgment which may not be made here.

Defendants Bullard, Wright, Wirthlin and Rich are jointly and severally liable for the difference between $40,000, the value of the 2,000 shares of stock issued to the partnership

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[19]Daniels v. Thomas, 10 Cir., 225 F.2d 795, 797-798, cert. denied 350 U.S. 932.

[20]50 C.J.S. Judgments § 634, p 68; 17 Am. Jur. Dismissal, Discontinuance and Nonsuit, § 91, p. 162. Cf. National Life & Accident Ins. Co. v. Parkinson, 10 Cir., 136 F.2d 506, applying Oklahoma law. There appear to be no Utah decisions on this point.

at $20 per share, and that sum which represents the cash advanced plus the value of the furniture and equipment furnished.[21] Interest should be allowed and computed on the basis that the stock for which there was a failure of consideration was the last stock issued to the partnership. Thus there will be interest on part of the recovery from April 11, 1954, and on the remainder from August 24, 1954.

In No. 5914 the judgment is affirmed. In Nos. 5977 and 6000 the judgment is reversed for the entry of a new judgment in conformity with the views expressed herein.

[21] The record establishes that the furniture and equipment had a fair value of $4,145 but we cannot ascertain the exact amount of cash advanced because the body of the stipulation of facts fixes this at $23,818.18 and an attached exhibit states the amount to be $23,888.17.

APPENDIX 1 TO PETITION FOR WRIT OF CERTIORARI

Excerpts from Utah State Constitution and Utah State Code. Section numbers refer to the Utah Code Annotated, 1953.

Utah State Constitution, Article XII, Section 5:

> "Corporations shall not issue stock, except to bona fide subscribers thereof or their assignee, nor shall any corporation issue any bond, or other obligation, for the payment of money, except for money or property received, or labor done. The stock of corporations shall not be increased, except in pursuance of general law, nor shall any law authorize the increase of stock without the consent of the person or persons holding the larger amount in value of the stock, or without due notice of the proposed increase having previously been given in such manner as may be prescribed by law. All fictitious increase of stock or indebtedness shall be void."

A substantially similar provision was held in Brown v. Watson, (1955) 139 N.Y.S. (2d) 628, 285 App. Div. 587, to impose liability upon director-promoters for issuance of stock of a corporation without consideration. The corporation was held to have the cause of action.

Code Sections:

> 31-1-18: "Within the intent of this code the business of insurance is one affected with the public interest, requiring that all persons be actuated by good faith, abstain from deception, and practice honesty and equity in all insurance matters. Upon the insurer, the insured, and their representatives rests the duty of preserving inviolate the integrity of insurance."
>
> 31-6-13: "The incorporators of any such insurer or corporation, or the persons proposing to form a reciprocal insurer, shall be jointly and severally liable for all its debts or liabilities until it has secured a certificate

of authority, if an insurer, or has completed its organization if a corporation other than insurer."

31-6-14(1): "No such proposed stock insurer, corporation, or syndicate shall issue any share of stock or participation agreement except for payment in cash or in securities eligible for investment of funds of insurers, or until all subscribtions received under the solicitation permit have been fully paid, and if an insurer, a certificate of authority has been issued to it."

31-6-15: "All applications for insurance obtained in the forming of a mutual or reciprocal insurer shall state that: (1) issuance of the policy is contingent upon completion of organization of the insurer and issuance to it of a certificate of authority; and that (2) the prepaid premium will be refunded in full to the applicant if the organization is not completed and certificate of authority issued prior to the expiration date of the solicitation permit; and that (3) the agreement for insurance is not effective until a policy has been issued under it."

31-6-16: "The commissioner shall withdraw all funds held in escrow and refund to subscribers and applicants all sums paid in on stock subscriptions, less that part allowed and used for promotion and organization expenses, and all sums paid in on insurance applications, and shall dissolve the proposed incorporated insurer or corporation, in event: (1) the proposed insurer or corporation fails to complete its organization and secure full payment for subscriptions and applications, and, if an insurer, fails to secure its certificate of authority, all before expiration of the solicitation permit; or if (2) the commissioner revokes the solicitation permit."

31-7-1: "The laws of this state relating to private corporations, except where inconsistent with the express provisions of this code, shall govern the corporate powers, duties, and relationships of incorporated domestic insurers."

31-7-7: "(1) No incorporated domestic insurer

shall enter into any contract the effect of which would be to grant or surrender the control and management of the insurer to any person.

(2) No incorporated domestic insurer shall make any contract whereby any person is granted or is to enjoy in fact the exclusive or dominant right to produce the entire insurance business for the insurer unless such contract is filed with and approved by the commissioner. The contract shall be deemed approved unless disapproved by the commissioner within thirty days after date of filing. Any such disapproval shall be delivered to the insurer in writing, stating the grounds therefor.

The commissioner shall not approve any such contract referred to in paragraph two of this section which:

(1) subjects the insurer to excessive charges for expenses or commissions; or (2) vests in such person any control over the general affairs of the insurer to the exclusion of its board of directors or officers; or (3) is to extend for an unreasonable length of time; or (4) contains other inequitable provisions or provisions which may jeopardize the security of policyholders."

31-7-10: "No domestic insurer shall:

(1) pay to any of its officers or directors any compensation except such as is authorized by its board of directors, and representing compensation in reasonable amount for services actually rendered or for commodities actually received or for salary accruing during period of vacation or temporary disability on account of illness or injury; or

(2) pay any pension to any person except to a former employee or officer entitled thereto in accordance with a uniform retirement plan for all employees, agents, or officers as adopted by its board of directors and approved by the commissioner; nor

(3) pay to any person who has the power to decide which applications to the insurer for insurance are to

be accepted or rejected, any compensation related to income upon risks so accepted, except upon the net profits therefrom."

31-7-12: "No person having any authority in the investment or disposition of the funds of a domestic insurer shall accept, except for the insurer, or be the beneficiary of, any fee, brokerage, gift, or other emolument because of any investment, loan, deposit, purchase, sale, payment, or exchange made by or for the insurer, or be pecuniarily interested therein in any capacity. . . ."

31-9-12: "(1) A domestic mutual insurer is owned by and shall be operated for the exclusive benefit of its members.

(2) Each member shall be entitled to one vote in the election of directors and on matters coming before corporate meetings of members, subject to such reasonable minimum requirements as to duration of membership and amount of insurance held as may be made in the insurer's by-laws. If such member be a minor, the vote shall be vested in the parent or legal guardian of such minor.

(3) With respect to the management, records and affairs of the insurer, the member shall have the same character of rights and relationship as a stockholder has and occupies toward a domestic stock insurer.

(4) The person named as the policyholder in any group insurance policy, or the payor in any family group policy, issued by such insurer shall be deemed the member and shall have but one such vote regardless of the number of individuals insured by such policy."

31-9-18: "(1) Each member of a domestic mutual insurer other than life, except as otherwise provided in this chapter, shall have a contingent liability pro rata and not one for another, for the discharge of its obligations. The contingent liability shall be in such maximum amount as is stated in the insurer's charter.

(2) Every policy issued by the insurer shall contain a statement of the contingent liability."

31-9-19: "(1) If at any time the admitted assets of a domestic mutual insurer doing business on the cash premium plan are less than its liabilities and the minimum surplus required of it by this code as prerequisite for continuance of its certificate of authority, and the deficiency is not cured from other sources, its directors may, with the approval of the commissioner, make an assessment on its members who, at any time within the two years immediately preceding the date such assessment was authorized by its directors, held policies providing for contingent liability.

(2) The commissioner shall refuse to approve the assessment if in his judgment such refusal will best promote the interests of the insured's members and creditors and of the insuring public.

(3) A member's proportionate part of any deficiency shall be computed by applying to the premium earned within such two-year period on his contingently liable policy or policies the ratio of the total deficiency to the total premium earned during such period on all contingently liable policies."

31-9-20: "The contingent liability of members of a domestic mutual insurer doing business on the assessment premium plan shall be called upon and enforced by its directors as provided in its by-laws."

31-9-29: "(1) A domestic mutual insurer on the cash premium plan may, with the commissioner's advance approval and without the pledge of any of its assets, borrow money to defray the expenses of its organization or for any purpose related to its business upon an agreement that such money and such interest thereon as may be agreed upon, not exceeding six per cent per annum, shall be repaid only out of the insurer's earned surplus in excess of its required minimum surplus."

31-11-1: "Stock insurers may transact kinds of insurance in this state upon qualifying therefor and by having paid-in capital and surplus represented by admitted assets, as follows:

	Minimum Capital Required	Minimum Surplus Required
(1) Life Insurance	$100,000	$25,000

. . .

31-12-2: "(1) The following shall not be allowed as assets in determination of the financial condition of any insurer: (a) good will, trade names, agency plants, and other like intangible assets; (b) prepaid or deferred charges for expenses and commissions paid by the insurer; (c) *advances to officers* (other than policy loans or loans made pursuant to section 31-7-12), whether secured or not, *and advances to employees, agents and others persons on personal security only*; (d) stock of such insurer, owned by it, or any equity therein or loans secured thereby, or any proportionate interest in such stock through the ownership by such insurer of an interest in another firm, corporation or business unit; . . .

"(2) All assets not allowed and all other assets of doubtful value or character included as ledger or nonledger assets in any statement by an insurer to the commissioner, or in any examiner's report to him, shall also be reported, to the extent of the value disallowed, as deductions from the gross assets of the insurer."

31-13-1: "(1) This chapter shall apply only to domestic insurers unless otherwise specifically stated.

(2) Domestic insurers shall invest in or loan their funds on the security of, and shall hold as assets, only eligible investments as prescribed in this chapter."

31-13-2: "(1) No securities or other investments shall be eligible for purchase or acquisition under this chapter unless they are interest bearing or income-pay-

ing, are not then in default in any respect, and the insurer is entitled to receive for its exclusive account and benefit, the interest or income accruing thereon; except as to real property acquired and occupied by the insurer for home and branch office purposes."

31-27-3: "No person shall knowingly file with any public official nor knowingly make, publish, or disseminate any financial statement of an insurer which does not accurately state the insurer's financial condition."

31-27-4: "No person shall knowingly make, publish or disseminate any false, deceptive, or misleading representation relative to the business of insurance or relative to any person in the conduct of the business of insurance."

31-27-12: "No director, officer, agent, attorney in fact, or employee of an insurer shall:

(2) make or concur in making any false entry, or concur in omitting to make any material entry, in its books or accounts; nor

(3) knowingly concur in making or publishing any written report, exhibit or statement of its affairs or pecuniary condition containing any material statement which is false, or omit or concur in omitting any statement required by law to be contained therein."

APPENDIX 2 TO PETITION

Condition of Mutual Company Prior to Conversion

Attached to the Stipulation of Facts between some of defendants and plaintiff in connection with the Second Cause of Action is a pro-forma balance sheet to reflect the books of the mutual company on June 30, 1953 (117). This statement itself shows a deficit on the books of the mutual compan of $9,605.57. Actually, however, the real estate contracts and mortgage loans shown on the books were not the assets of the mutual company but belonged to the stock company as a result of sales of stock. (See Schedule K-1 to the Stipulation of Facts (119). (See also Bullard's letter of June 28, 1952, 108-110, and the escrow agreement, 106-108.) The mutual company was holding the real estate equities as trustee for the stock company. It is therefore necessary to remove the item "real estate contracts of sale, $64,837.07" as an asset and the items "accounts payable $21,812.00" and "mortgages payable real estate contracts $43,128.00" as liabilities. Moreover, the mutual company owed to the stock company the amount of profit appearing in the last column of Exhibit K-1 under the heading "Income from real estate No. 141 cr." (119). In addition, the mutual company had received advances from LICOA Agency in the total sum of $28,033.17, none of which appeared in the records of the mutual company as a liability (99). After these adjustments are made to conform to the facts, the balance sheet of the mutual company immediately prior to its conversion to the stock operation would be as follows:

Assets:

Bonds	$ 5,000.00
Stock	4,781.30
Petty cash	100.00
Bank (Overdraft)	(5,940.74)

Agents' balances	(3,865.26)	
Accounts receivable	7,045.84	
Returned checks	277.60	
Total assets		$ 7,488.74
Liabilities:		
Premium suspense	116.70	
Federal income, W.H. payable	865.60	
FICA payable	109.29	
Exchange account	7,051.25	
Special policy saving	(76.14)	
Reserves	6,777.15	
Unpaid claims	6,196.69	
Due stock company as profits on real estate contract transaction	3,163.28	
Accounts payable	432.00	
LICOA Agency advances	28,033.17	
Total liabilities		52,668.99
Deficit		$45,180.25

It should be observed that the foregoing pro forma statement of the mutual company is conservative in reflecting its total deficit. There are a number of liabilities not shown. Such liabilities include the amount of commissions purportedly due to LICOA Agency for which stock was subsequently issued (Exhibit K, Note 2, 117; See findings of court on second cause of action, 139, 143) and reserves in addition to the amount shown. The reserve figure, $6,777.15, is that contained in the annual report for the mutual company as of the end of December, 1952; reserves are actuarily computed annually; the amount of reserves at the end of 1953 were computed to be $26,856.54. If half the reserves for the year were estimated as of June 30, the reserve figure would be $13,432.00; Note 3

to Exhibit K, 118). It is also to be observed that the liabilities do not include current accounts payable, except the amount due to Irving C. Burgoyne (Ex. K-1, Col. 6, 119). That the mutual company was desperate for cash appears from the fact that it was overdrawn at the bank in the sum of $5,940.74 and on its agent's balance account in the sum of $3,865.26 (Ex. K; 117).

APPENDIX 3 TO PETITION

This letter appears in the Record at pp. 53-56.

Birrell, McGee, Zimmerman & Thomas
Certified Public Accountants
Continental Bank Building
Salt Lake City 1, Utah
June 22, 1953

Board of Directors,
Life Assurance Corporation of America,
Atlas Building,
Salt Lake City, Utah
Gentlemen:

In accordance with your request we have made an examination of the proceeds received to date in connection with the sale of capital stock of your corporation. As of June 22, 1953, the corporation had sold $214,780.00 worth of capital stock by the subscription method. As of the above date the corporation had received cash, real estate contracts, notes and subscription notes making up the above amount. We have examined or confirmed as in the case of the cash in bank, the above mentioned items. A summary of these items is as follows:

Cash received and deposited	
Zion's Benefit Building Society	$ 4,871.30
Utah Savings and Trust	47,774.02
Cash in transit due from corporation	1,000.00
Total cash on hand or in deposit	53,645.32
Cash paid out for commissions	12,421.45
Total	$ 66,066.77
Contract notes paid to the corporation covered by first mortgages and assign-	

ments of real estate contracts		$ 30,380.00
Personal notes other than subscription notes		33,561.71
Cash, securities, equipment and services contributed by original incorporators		25,000.00
Subscription notes receivable		59,771.52
		$214,780.00
Cash in bank	$ 53,645.32	
Mortgage notes receivable	30,380.00	
Notes receivable	58,561.71	
Subscriptions receivable	59,771.52	
Commission on sale of stock	12,421.45	
Capital stock outstanding		107,390.00
Paid in surplus		107,390.00

The journal entries to record the above items on the books of the corporation will be as follows:

Assets	
Cash	
Zion's Benefit Building Society	$ 4,871.30
Utah Loan and Trust	47,774.02
In transit	1,000.00
Real estate equities	18,580.00
Total assets	$72,225.32
Liabilities	
Commissions on sale of stock	$30,000.00
Net worth	42,225.32
Total	$72,225.32
Assets	
Mutual company assets	$ 7,488.74
Stock company assets from escrow	72,225.32
Total assets	$79,714.06

Liabilities	
Mutual company liabilities	$52,668.99
Liabilities from sales of stock	30,000.00
Total liabilities	$82,668.99
Deficit	$ 2,954.93

As you will note from the above entries, the corporation appears to have met the requirements of the various statutes and regulations requiring $100,000 of capital stock together with $25,000.00 of paid in surplus through the sale of capital stock and therefore, should be in a position to request the issuance of their charter as a stock insurance company.

In connection with our examination of the various items mentioned in the first page of this letter we submit the following comments.

The cash in the bank was confirmed to us by direct correspondence with the depositaries.

The cash in transit was confirmed by letter received from the corporation.

Cash paid out for commissions was confirmed by examination of the checks issued in payment therefor, together with the deposits of such cash to the account of the corporation.

Contract notes in the amount of $30,380.00 were examined, and based upon the information submitted to us, appear to be fully collectible and at full value with proper documents supporting such amounts.

The personal notes of $33,561.71 were examined and based on information submitted to us, appear to be fully collectible.

In connection with the $25,000.00 contributed by the

original incorporators, this amount is the minimum amount guaranteed by those individuals. Under date of July 13, 1951, Mr. A. S. Thatcher, a certified public accountant, submitted a statement showing certain assets having been purchased by a partnership and subsequently additional amounts were paid in by the individuals in this partnership. Under signature of Mr. Cleo Bullard, the partnership was guaranteed to the corporation, that these assets and/or expenses paid out for the benefit of the corporation are at least $25,000.00. We were informed that if the Insurance Commission should not accept any of the various items turned over to the corporation by this partnership, they have guaranteed that at least that amount ($25,000.00) will be paid in. Based on the audit and report mentioned above, we are of the opinion after considering the usual commission allowed of 20 per cent in sale of stock that there is at least $25,000.00 worth of assets and services turned over to the corporation and no deficiencies will exist. After acceptance by the various state authorities, this amount will be distributed on the balance sheet of the corporation in accordance with good accounting principles.

The subscription notes receivable in the amount of $59,771.52 were examined and we noted that at the present time current payments are being made on at least $20,000.00 of these notes, indicating the intent of the stockholders to make payment in accordance with their agreements with the corporation.

Yours very truly,

Birrell, McGee, Zimmerman & Thomas
Robert L. McGee

RLM:mj

APPENDIX 4 TO PETITION

Analysis of the assets referred to in the McGee letter of June 22, 1953, attached to this petition as Appendix 3. Page numbers refer to the pages of the record as printed for use by the Circuit Court. References to the code refer to the Utah State Code Annotated, 1953, Sections referred to are reproduced in Appendix 1 to this Petition.

The purpose of this analysis is to demonstrate that the information contained in the letter analyzed is misleading in failing to disclose that the itemized assets were largely worthless, and that their acceptance by an income company would violate Utah law.

Of the total assets referred to in the McGee letter, allegedly representing values of $214,780.00, $142,554.68 were non-admitted assets and worthless. Further, there was a liability against the balance in the sum of $30,000.00.

The McGee letter (53-56) itemizes the assets in question and recommends the journal entries to record the same on the books of the corporation. This letter is reproduced as Appendix 3 to this petition and the itemization need not be repeated here. It is to be observed that in the recommended journal entries, the items "notes receivable—$58,561.71" combines the items "Personal notes other than subscription notes—$33,561.71" and the items "Cash, securities, equipment and services contributed by original incorporators—$25,000.00." These items, however, are separated here for proper analysis.

Subscription Notes

The largest item in amount is that shown as "Subscription notes receivable—$59,771.52." The form of this note was identified by both McGee and Bullard (432) and appears as

Exhibit 5 (331, 332). The note provided that in the event the maker failed to pay the installments, the sole remedy of the holder was to retain the sums then paid as "agreed and liquidated damages and cancel and reposses the shares of stock they purchased." "No deficiency judgment shall be taken against the maker hereof in such event." It is, of course, obvious that the corporation had no right to obtain the balance of the note by its very terms. The individual makers and amounts of these notes were identified by Bullard (444-445). The members of the board, during the spring of 1954, concluded after discussion that these notes had no value, without regard to whether they were admissible (450-451). In many instances stock certificates were actually completed and delivered for these amounts (488; at 337 the specimen certificates referred to are shown to be in the amount of $10,000.00). Obviously there were personal notes and therefore prohibited under Section 31-12-2 of the Utah Code. The acceptance of notes in payment for stock is also prohibited, even as to ordinary business corporations, by 76-13-4 U.C.A.(1). Inasmuch as the notes could not be collected, their characterization as assets in the first instance is wholly misleading.

Personal Notes

The form of the instrument represented by the item "Personal notes other than subscription notes—$33,561.71" appears in the record at 332 as Exhibit 6. The makers of these notes were identified by Mr. Bullard (440). For the most part, they were employees or agents of the company (440, 441). Personal

(1) 76-13-4. "Every director of any stock corporation who concurs in any vote or act of the directors of such corporation or any of them, by which it is intended either: . . .

"(3) To discount or receive any note or other evidence of debt in payment of any installment actually called in and requiredto be paid, or with the intent to provide the means of making such payment . . . is guilty of a misdemeanor." Construed in Pace v. Pace Bros Co., 91 Ut. 149, 63 P. (2d) 590.

notes and notes of agents and employees are expressly prohibited by Section 31-12-2; these items, as the subscription notes, also violated Sec. 76-13-4. There was an additional reason why these personal notes had no value in this particular case. The "terms and conditions" of the Securities Commission (479-480) which were accepted in connection with the sale of the stock (478), provided that where a stock was sold on an installment plan and notes taken, the exclusive remedy of the issues would be to repossess the securities "and no deficiency judgment against the maker of the note will be allowed" (479-480). All of the defendants in this action were of the understanding that these terms and conditions were a part of the note and caused that the notes were actually uncollectible instruments (441-442). McGee was expressly advised of such understanding (ibid.).

The LICOA Agency Items

The McGee report itemizes "Cash securities, equipment and services contributed by the original incorporators—$25,000.00." In actual fact this was an estimate at that time. The item was supposed to represent the amount of advances to the mutual company set up on the books of the mutual company as "contributed surplus" but which the LICOA Agency members secretly claimed to be a liability against the mutual company (99,100). By the time of the McGee letter, the mutual company was insolvent. The trial court expressly found that any claim the partnership might have had against it was valueless (139). There were, of course, no assets in the mutual company at this time which the stock company would receive with respect to this amount. The treatment of this item obvious constitutes juggling of the most flagrant kind. These directors called their worthless claim against the mutual company an asset of the stock company and in due course caused stock to be executed for it, while the stock company actually

assumed the obligations of the insolvent mutual company. The decision of the trial court discusses this transaction in greater detail (esp. 143-145). It does not appear to be necessary to repeat the analysis here.

The Real Estate Equities

The real estate contracts in the amount of $30,380.00 were all non-admitted assets. Of this amount, items totaling $11,800.00 were worthless. The items shown as real estate contracts in the McGee report were identified by Bullard (442). Three of the eight persons who were involved in these transactions were employees of the company (ibid). These amounts represented the difference between a first mortgage and the amount due on an executory real estate contract (442, 443). They were, in other words, in the nature of second mortgages. The Insurance Code, 31-13-12, provides in substance that insurance company investments are limited to first mortgages as far as real estate investments are concerned. The Insurance Commissioner and the Attorney General of the State of Utah subsequently rendered an opinion to the effect that the real estate contracts held by the defendant corporation were not admitted assets. Mr. Bullard testified that after some argument of the point, the corporation acquiesced in his ruling (458). Of the total amount of the real estate equities, $11,800.00 worth were "reclassified" to subscription notes and cancelled by the corporation the next spring (see Schedule 6-C, 347). It is apparent that the contracts represent by the cancelled items were worthless from the beginning. To summarize on this point, all of the $30,300.00 under the heading "real estate contracts," were illegal investments and $11,800.00 of said amount was totally valueless. Defendants are thus given the full benefit of any value that exists in these contracts, notwithstanding their status as non-admitted assets under the Code.

Cash Paid Out for Commissions

The item "Cash paid out for commissions—$12,421.45" was obviously of no value. That money was gone. The corporation didn't have it and had no right to it. Nor is any credit possible because of prepaid commissions. Section 31-12-2 expressly provides that "prepaid or deferred charges for expenses of commissions paid by the insurer" shall not be allowed as an asset in determining the financial condition of any insurer.

The Liability for Stock Sales Commissions

The stock corporation moreover had a liability to Mathew J. McCormick in connection with the issuance of its capital stock which was not disclosed at the time of the conversion. The Utah State Supreme Court held that although Mr. McCormick's contract entitled him to receive 20% commission on all assets accepted by the company at the time of the conversion, he was only entitled to receive 15% under the Utah statute. *McCormick v. Life Insurance Corp. of America*, (1957) 6 Utah (2d) 170, 308 P. (2d) 949. The liability existed because the corporation was caused to accept the assets and thus undertook the risk involved in their ownership. All of these promoters, including McGee, were aware of the existence of the McCormick contract (363), and knew, or at least are chargeable with the knowledge, that there was a liability of some kind to him. Failure to disclose the existence of the liability in some form makes the statement misleading. Fifteen per cent of $214,780.00 is obviously more than the $30,000.00 which is the figure used by plaintiff herein in estimating this liability. In addition, McCormick was eventually allowed attorney's fees, interest and costs, so that the total payment to him was well in excess of the $30,000.00 liability plus any cash payments which might have been made prior to that time.

Some of the items originally accepted as such at the time of the conversion to a stock company were cancelled prior to December 31, 1953 (Schedule 8, 347). All of the balance of the items referred to in this analysis as having no value were declared non-admitted assets by the Insurance Commissioner in the spring of 1954, and after due consideration, were cancelled and eliminated as assets by the board of directors at that time. Defendants Bullard, Pugsley, Wright and Wirthlin were controlling members thereof (261). Recommendation for cancellation was made by McGee (262).

After making the adjustments indicated by this analysis assets being held in escrow, and liabilities to which they were subject would be substantially as follows:

Immediately after the completion of the conversion, and coincident with the birth of the corporate infant, the stock company had net assets of minus $2,954.93. This appears from the following pro forma statement, taking into account the combined assets and liabilities in the stock and mutual companies:

The only conclusion which can be reached is that the legal infant was born with an actual deficit of $2,954.93, whereas its existence was predicated upon the assumption that it had $214,780.00 in assets and no liabilities.

All the promoters, especially McGee, knew the facts (438, 439, 443). The Insurance Commissioner may have known some of them. But the stockholders, to whom the disclosures were due, were kept blissfully ignorant.